United States Court of Appeals

for the Second Circuit

PETITIONER'S REPLY BRIEF

76-4236

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

MAR 21 1977

NO. 76-4236

F. K. KERPEN & CO. INC. AND
FRED K. KERPEN
Petitioners

v.

SECURITIES AND EXCHANGE COMMISSION
Respondent.

B
P/S

On Petition for Review of an Order
of the Securities & Exchange Commission

REPLY BRIEF BY PETITIONER

THE ISSUE

If it were not for 'weltfremde' bureaucrats, the response to ONE OF THE ESSENTIAL POINTS OF MY ARGUMENT - the involvement of a Mutual Fund organization in the relationship of a superior to a broker/dealer - , dealt with in one sentence of the next-to-last footnote to the next-to-last paragraph of the Counterstatement of the Issue, namely that the NASD has no jurisdiction to initiate disciplinary proceedings since the Dreyfus Fund, Incl is not a member, would be sheer hypocrisy. I have caused, and assisted others to cause, hundreds of investors, individual and institutional, to invest

many, many millions into the Dreyfus Fund - yet I have never had any dealings with the Fund. True in my brief I used the terms Fund, Mutual Fund, Dreyfus, and Drefus Fund interchangeably, reflecting an entity with whose distributive arm my contact and contractual arrangements exist. From the Dreyfus literature:

> Howard Stein.....Chairman of the Board of the Fund, Chairman of the Board and Chief Executive Officer of the Dreyfus Corporation and the Dreyfus Sales Corp.

The Dreyfus Sales Corporation, henceforth referred to as Dreyfus, member of the NASD and subject to its By-Laws (including the observation of high standards of commercial honor and just and equitable principles of trade) was the one which dealt with Nebenzahl at first - in camera. Please refer again to my first brief and the references cited therein. They make it abundantly clear that I haven't filed away the Borowic letter "on the basis of a telephone call and a letter from Dreyfus". A follow-up call to the complaining customer would not have been that simple, being that the customer resided in Lausanne, Switzerland. The Counterstatement implies that I as a broker/dealer had to proceed on the assumption that Dreyfus did not know how to handle a metter of fraud and deception, that I was to check on them on receipt of the Borowic letter copy, when all the contacts I had there reassured me that the matter had been taken care of and confirmed my assessment of a crank letter.

Nebenzahl was associated with a broker/dealer by name of Barron Helbig. When Mr. Helbig died I took over his accounts. Mrs. Eve Brooks, who had been associated with Helbig for the preceding

27 years joined my firm. She persuaded Nebenzahl who was dissatisfied with the limited Mutual Fund knowledge of the member-firm (of the NY Stock Exchange) he had gone to, to also join my firm. All of Helbig's Nebenzahl accounts which had been transferred to that firm (if required I can supply the name from the record) were re-transferred to my firm as broker/dealer of record. Even without that double transfer it was physically impossible to check whether all accounts had been transferred - some always are lost in the computer process - how many there were (hundreds), who they were, whichones were active, etc. This is important for Nebenzahl turned crooked in 1968 or 1969, whereas I had no idea with whom he was dealing and how. All I knew then was that he was extremely knowledgeable, highly competent and had an outstanding reputation in the field. He was a valuable addition to my small stable of financial planning professionals. It is tiresome to repeat this here again, but his dealings at that time included getting clients to make out 2 checks, one to him for later investment when he thought the time was propitious and the otherone to the custodian bank. The latter he forwarded promptly to me and I processed and passed it on immediately. Facts concerning this were noted by the first committees hearing this case and are on record. The Commission, however, goes on to point out that I had kept the man on until September 1971 although he was falsifying signatures and converting customers' moneys since 1968 or 1969.

What I n o w learn from footnote 13/, page 9 of the Counter-statement, ENTIRELY NEW TO ME , is that Nebenzahl had written a letter (R 136) " admitting his crime and begging to be given another chance " . When was this letter written and to whom ? In which record is it ? How come I was never shown a copy ? Who withheld it from me ? Does the NASD know about it

and has it failed to institute proceedings? At the time when it was written or later during these proceedings ? May I take a look at it ? I move that I be given an opportunity to see it.

There is admission of crime by Nebenzahl, apparently back in the late 60s. It has been aired repeatedly in Committees, documented in various papers, established as a fact. Nebenzahl does not bother to respond to the NASD or to appear at a hearing. He now gets credit for not appealing the District Committee's decision and for not seeking Commission review. Three lawyers' time is taken up to make my penalty stick. What I don't understand is why one of them doesn't pick up the telephone and turn the matter over to the District Attorney ? Or dictate a letter to his secretary to that effect?

Misconceptions of the facts by the Commission begin early in the case. Take the wording of the complaint as quoted on page 3 (R 11 - 14). Respondent's brief concluded that - because I didn't challenge the First and Third Cause of Complaint - the facts are accurate, that I am familiar with them and that I agree with them. In the hearing it became quite clear (I learned most of the facts then and there) that Nebenzahl caused the Rutners, not " to issue two checks for $ 7,500.00 for the designated puppose of investment into the Dreyfus Fund, Inc., but which he instead converted to his own use without the consent of the customers ", but that he had made them draw two different checks for $ 7,500.00 each, one to the custodian bank which he forwarded to me and which I promptly passed on, and the otherone to himself for later investment at his dis-

cretion. The time never came and the money ended up in Nebenzahl's pocket. But I did not know at that time who the Rutners were or their son-in-law Siff, who had accounts with Nebenzahl, or who he was dealing with. At this point I would like to mention parenthetically that all business Nebenzahl brought in to me DIRECTLY is and was in the same good order as all my business is.

Similarly the Commission assumes erraneously that I had knowledge or could have had knowledge of all or some of Nebenzahl's machinations in the late 60s and early 70s (with people of whose existence I had no knowledge) and now sees its assumption proven because I didn't challenge paragraph 1 and 3 of the complaint. The canard about my awe of Nebenzahl's selling talents was laid to rest in my appeal, dated June 12, 1974, pages 5 and 6. There was no incentive, pecuniary or otherwise, in my letting Nebenzahl to conduct himself without 'instructions'. To the contrary, had I cut Nebenzahl off earlier, during the Shayhouse period, I would have benefitted as his commissions would have remained with my firm.

The Commission's opinion states:

> " Mr. Kerpen explicitly waived any opportunity to present oral argument "

When I appealed my case to Washington I had, aside from a decimation of my own holdings, lost my business. Income from it became so low that it did not provide for upkeep of a most modest office. I moved my office into my home. Approaching 65 and unable to maintain coverage for Social Security I took a job in a bucket shop on Wall Street. I thought I had put my case in

writing as well as I could and left to the discretion of the Commission: "Should the Commission, however, wish to gain a personal impression, I'll be glad to appear in Washington." Little did I think then that this could be turned into an 'explicit waiver of any opportunity to present oral argument'. When the matter dragged on over a year, a painful, time-consuming, costly, harmful thing, I asked for a personal appearance but then it was too late. I will surely appear in person before the court.

Respondent notes that Nebenzahl's employment with my firm was not terminated until September 1971 whereas I had reason to believe as early as February 1970 that he had acted wrongfully. This refers to the Shaynhouse case. Here a Doctor gave Nebenzahl cash and Nebenzahl did what he had done in the Borowiec case. Only it was easier. The latter should have alerted me while another NASD-member, Dreyfus, (whose duty includes apprzing me of the facts) was apparently doing its duty by obtaining a letter from Nebenzahl in which he admits his crime. And keeping it secret from me. The Commission bases its assessment of my lack of supervision on the failure to heed the Borowiec letter. Dreyfus didn't heed it and I didn't. Both gave the guy a slack in the rope to permit him to work out his problems. Dreyfus is not even involved in this or any other hearing. But me they hang - to teach others.

ARGUMENT

This Court has held, the Respondent's brief informs me, that the factual findings of the Commission are not to be disturbed unless

they are clearly erreneous. I submit that Respondent's findings are clearly erroneous, vize:

" Petitioners did not challenge the First and Third Causes of Complaint which were directed at the adtivities of Nebenzahl"

Except for the Borowiec letter, I was in complete ignorance of the shady side of Nebenzahl, as well as of the fact that he had written a letter admitting his crime and asking for another chance. (R 136). I learned the gruesome details from telephone conversations with the Rutners and Siff, summarized in the Complaint. All acounts which Nebenzahl conducted business through me are in the same order as all my accounts are.

Another error is the omission of the fact that the attachement in the Shaynhouse case was withdrawn almost immediately.

Respondent errs when the Counterstatement of the Issue repeats: "Nebenzahl was permitted to remain with the firm until September 1971, some time after Mr. Aerpen was advised that additional customers had been victimized by Nebenzahl's similar activities." (R 199-204). When Mr. Siff, son-in-law of Mr. & Mrs. Rutner, - I had never heard any of these names before, nor did I know who they were, that they were clients, that Nebenzahl talked with them or others - when Mr. Siff telephoned to complain I advised him to notify the District Attorney and to contact the NASD for assistance. I myself consulted with the local NASD office and discontinued Nebenzahl's employ. (See record).

Respondent dwells on Nebenzahl's propensity to misappropriate customers' funds (which tunred out to be a fact) as if I were in knowledge of it during the Shaynhouse period. Nebenzahl was then at the height of his career, associated with one of

the most prestigious life insuranne agencies in town.

Respondent errs when it states that a Siff letter copy was found in my files. No such letter copy has been found in my files, to-date I have never seen Mr. Siff's letter to the NASD. It was I who suggested to Mr. Siff to turn to the NASD for assistance. Apparently Respondent confuses that with the fact that a copy of Mr. Borowiec's letter to Mr. Stein has been found in my files. I surely would never have left it there had I not been convinced that it was a crank letter (which I filed away and forgot about) - a conviction which was amply supported by Dreyfus. (See record).

The harm the announcement of the 10-day suspension has done me already is far in excess of any punishment that fits my 'crime' - even though it cannot be measured in Dollars and Cents. Actual suspension would be ruinous. A lawyer in a Government office may not think that two weeks of inactivity will make much of a difference. In a multi-employee firm 'someone else writes the ticket'. For a one-man shop it is more than oppressive and certainly a burden on competition unnecessary and inappropriate in furtherance of the purposes of retribution or example-setting. I would have to send my clients to the competiton or away and they don't come easy these days, if at all. Even the Respondent had to acknowledte my personal honesty. Not to let me ply my trade, aside from the severe damage to reputation with the public and standing in the brokerage community, is oppressive as well as excessive.

Petitioner therefore requests that the Court examine the 'administrative competence' of Respondent with respect to acdeptance

of his (and his firms) violations as found by the NASD. The Supreme Court, the Counterstatement informs me, has emphasized that, "where Congress has entrusted an administrative agency with the responsibility of selecting the means of achieving the statutory policy 'the relation of remedy to policy is peculiarly a matter for administrative competence'". If such administrative competence is wanting in one area, can it be assumed to be applicable in the instant case to the acceptance of violations as found by the NASD ?

As a small broker/dealer (along with 100s, previously 1,000s, small and large) I have been subjected for many years to commission expropriations and unwarranted, unaccepted charges by Mutual Fund distributors. After a struggle of more than a decade within the industry and the trade association, the NASD, I have turned to various divisions of the Commission for relief. The Commission is charged with the duty of enforcing the statutes in the 'public interest'. Is it in the public interest to permit one segment of the investment industry to exploit another? Be it by inaction or by internal decision not to regulate the relationship between Mutual Fund distributors and retailers? Does not the bestowal of the administration of the public interest confer a fiduciary duty on the executor? The Commission fails to exercise the 'broad discretion' mandated it, thereby supporting a dishonesty which has been going on in the mutual fund field for years, without opposition from, and when cases came up for proceedings, with open support by the NASD.

This is not in the public interest. It behooves administrative competence to protect the general public in this specialized

field. A broker/dealer, although part of the investment community, is also part of the general public.

Lack of administrative competence in one area impairs confidence in administrative competence in general. In the instant case the opinion of Respondent rests on the facts as established by the NASD. Both are faulty. I reiterate therefore my request that the affirmation of the findings of the Board of Governors of the NASD. confirmed by the opinion of the SEC, be overturned, the suspension revoked, and the censure, if confirmed by the Court, be kept unpublicised as required by the NASD By-Laws.

Respectfully submitted

Fred K. Kerpen

Fred K. Kerpen
(F.K.Kerpen & Co., Inc.)

March 1977